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No. 146

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

THE AMERICAN METAL COMPANY, LIMITED,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit (Chase, Medina and Hincks, *JJ.*) affirming the judgment herein of The Tax Court of the United States (Murdock, *J.*) determining a deficiency in income tax of petitioner and its affiliated companies for the calendar year 1947 of $2,180,517.99.

Citations to Opinions Below

The opinion and findings of the Tax Court (R.* 272a-286a) are reported in 19 T.C. 870 and are printed in Appendix A** hereto (*infra*, pp. A-18—A-31). The opinion of the

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* References to "Appendix to Brief of Respondent-Petitioner, The American Metal Company, Limited", in the Court of Appeals are indicated thus "R. ".

** References to Appendix A are indicated thus: "*infra*, p. A- ".

Court of Appeals, unreported as of the date of the printing of this petition, is printed in Appendix A hereto (*infra*, pp. A-3—A-17).

Jurisdiction

The judgment of the Court of Appeals was dated March 15, 1955 and was entered on the same day (*infra*, pp. A-1—A-2). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1) and Section 7482(a) of the Internal Revenue Code of 1954.

Questions Presented

1. Did not the Court of Appeals err in holding that the Mexican Production Taxes, paid by petitioner's Mexican mining subsidiary, could not be deemed income taxes for purposes of the foreign tax credit provisions of Section 131 (a)* of the Internal Revenue Code of 1939, because such Production Taxes, in the Court's opinion, were "privilege" or "excise" taxes?

2. Did not the Court of Appeals err in holding that the Mexican Production Taxes, paid by petitioner's Mexican mining subsidiary, could not be deemed taxes in lieu of income taxes for purposes of the foreign tax credit provisions of Section 131 (h)** of the Internal Revenue Code of 1939, because such Production Taxes, in the Court's opinion, were "privilege" or "excise" taxes?

3. Did not the Court of Appeals err in invoking standards established by this Court to resolve constitutional conflicts peculiar to our federal system, erroneously disregarding the intrinsic and economic nature of the Mexican Production Taxes involved and attempting instead to determine, without regard to such nature, whether they should

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* Section 901 of the Internal Revenue Code of 1954 is substantially unchanged from Section 131 (a).

** Section 903 of the Internal Revenue Code of 1954 is substantially unchanged from Section 131 (h).

be formally classified as "excise" or "privilege" or income taxes in the sense of the constitutional precedents in this Court?

4. Did not the Court of Appeals err in that it misapprehended the standards it sought to derive from the decisions of this Court directed to resolving constitutional conflicts peculiar to our federal system, and, in consequence, in that it misapplied such standards in holding that the Mexican Production Taxes were "privilege" taxes, notwithstanding that the taxes were not described, considered or treated as "privilege" taxes in Mexico, that payment of the taxes did not condition the exercise of the supposed taxable privilege and that a different and co-existing Mexican tax did condition the exercise of the supposed privilege?

Statutes and Regulations Involved

The following provisions of the Internal Revenue Code of 1939 are directly involved in these proceedings:

"Sec. 131. Taxes of Foreign Countries and Possessions of United States

"(a) ALLOWANCE OF CREDIT. If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102, shall be credited with:

> "(1) *Citizens and Domestic Corporations.* In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and
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> • • •

"(h) CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES. For the purposes of this section and section 23 (c) (1),

the term 'income, war-profits, and excess-profits taxes' shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States."

All of the pertinent provisions of the Internal Revenue Code of 1939 and of Title 26 of the Code of Federal Regulations are set forth in Appendix B hereto (*infra*, pp. B-1 - B-5).

Statement

A. Proceedings in the Courts Below

Petitioner, a New York corporation, and its affiliated companies filed a consolidated income tax return for the year 1947 with the Collector of Internal Revenue for the Second District of New York (R. 13a-14a) wherein petitioner claimed credit against its United States income tax liability, under Sections 31 and 131 of the Internal Revenue Code of 1939, for $4,322,614.22 of taxes paid to foreign countries. Respondent reduced the credit to $2,182,673.58, made miscellaneous adjustments to consolidated net income and on September 29, 1950 mailed to petitioner a notice of his determination of a resulting deficiency in tax of $2,180,517.99. Petitioner filed a petition for the redetermination of the asserted deficiency in the Tax Court on November 28, 1950. Respondent answered the petition on January 8, 1951 and on March 3, 1953 amended his answer to assert against petitioner and its affiliated companies for the year 1947 an additional deficiency of $208,242.28, based upon a further decrease in the credit allowed for taxes paid to foreign countries. The total deficiency asserted by respondent was $2,388,760.27.

A hearing in this proceeding was held by a division of the Tax Court sitting in New York City, on March 3 and

4, 1952, Judge J. Edgar Murdock presiding. The Tax Court promulgated its opinion on February 20, 1953 and on February 26, 1953 entered its decision ordering and deciding that there was a deficiency in income tax of $2,180,517.99 for the year 1947.

Both the petitioner and the respondent petitioned the Court of Appeals for the Second Circuit to review the Tax Court's decision. The Court of Appeals heard argument on November 4, 1954 and rendered its decision and opinion (Hincks, *J.*) on March 15, 1955 affirming the decision of the Tax Court.

B. Petitioner's Claims for Credit

Throughout the year 1947 petitioner owned more than 98 per cent of the stock of a Mexican corporation named "Compania Minera de Penoles, S.A." (hereinafter called "Minera") (R. 15a). In August 1947 Minera declared and paid a taxable dividend of $8,250,000 in United States dollars of which petitioner received $8,110,932.50 (R. 15a, 33a-34a). The dividend of $8,250,000 so paid by Minera effected a distribution of all the "accumulated profits" of Minera for the years from 1925 to 1947, plus most of the accumulated profits of 1924 (R. 16a-17a, 13a-34a).

Over the years 1924 through 1947 Minera had paid taxes with respect to the $8,250,000 of accumulated profits, in the amounts of $1,810,872.62 under the Mexican "Income Tax Law" (R. 27a-28a, 33a) and $5,568,708.73 in the form of "Production Taxes" under the Mexican Mining Tax Law (R. 17a-24a). The respondent credited petitioner for the appropriate portion, determined pursuant to Section 131(f), of the taxes Minera had paid under the Mexican Income Tax Law (R. 16a), but respondent denied petitioner any credit for the Production Taxes which Minera had paid under the Mexican Mining Tax Law (R. 16a). The Tax

Court and the Court of Appeals sustained the respondent's disallowance of any credit for the Production Taxes.*

Petitioner was thus denied any relief from double taxation for the most substantial portion of the taxes paid by Minera to Mexico.

C. The Mexican Tax Structure

Mexico has no inclusive income tax law (R. 219a, 201a, 204a). The Ley Del Impuesto Sobre la Renta, commonly called the Mexican Income Tax Law, is a schedular tax which imposes under five completely distinct schedules five distinct taxes on five types of income distinguished by their origins (R. 201a). Taxes on personal effort are at the lowest rates; on pure investment income, at the highest rates; and on combined capital and personal effort at intermediate rates (R. 202a). Schedule III, the second of two schedules taxing investment income, is directed to investments of capital in concerns requiring governmental permission or authorization, and the tax under this Schedule is higher than that under Schedule II, which is otherwise similar (R. 213a).**

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* By his amended answer in the Tax Court, respondent contended that in computing petitioner's credit based on Minera's tax payments to Mexico, a different rate of exchange should be employed to translate the Mexican tax payments into dollars than the rate which petitioner had employed in its return and that, accordingly, there was an additional deficiency of $208,242.28 (R. 5a-8a). The Tax Court and the Court of Appeals have both determined this point in favor of petitioner (*infra*, pp. A-15—A-17, A-30), and the present petition does not seek to submit the issue pertaining to the rate of exchange to this Court.

** The special significance of this schedular tax is that, upon the holding of the Court of Appeals in the instant action, this tax would have to be classified as a "privilege" or "excise" tax although it is in fact presently accorded the credit as an income tax. *Santa Eulalia Mining Co.*, 2 T.C. 241 (1943), Acq. 1946—1 C.B.4; I.T. 3787, 1946—1 C.B.232.

The Mexican Income Tax Law taxes income by sources and taxes each source upon a different basis, taxing some sources on a net profit basis, others on a gross receipts or a gross profits basis (R. 170a-172a, 207a, 212a-214a). If income of a kind described in more than one schedule is received by the same taxpayer, a separate return is filed by the taxpayer for each schedule; and neither the income nor the tax is aggregated from schedule to schedule (R. 202a-203a).

All of the taxes imposed under the Mexican Income Tax Law are presently accorded the foreign tax credit. (See Prentice-Hall, Federal Tax Service, 1955, Vol. 1, p. 5838.)

The Mexican Income Tax Law does not reach all income from whatever sources derived as does our own but excludes a number of classes of income, some of which are taxed under distinct laws (R. 203a-204a, 205a)*. Thus, in Mexico the Mexican Income Tax Law is not the all-inclusive means by which income is taxed, but other taxes also exist which are addressed to income and profits, and, in addition, there are income and profits which are not taxed at all.

The Mexican Production Taxes—the subject of these proceedings—further exhibit the Mexican fisc's preoccupation with the source of income and the selectivity of its imposts. The mining industry is, and has been for many years, a main source of the national economy of Mexico (R. 69a). In view of the general attention to the sources of income, it is entirely natural that this special source of income and wealth for the individual taxpayer and for the nation continues to bear a separate tax burden.

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* For example, rentals derived from non-commercial property, income derived from capital gains on the sales of fixed assets and income from lotteries and gambling are not taxed by the Mexican Income Tax Law (203a-204a).

The Production Taxes are imposed under the Mining Tax Laws (R. 141a-142a, Ex. 4-D(7); R. 35a, 57a). In general, the Mexican Mining Tax Laws have levied three distinct imposts, an area or surface tax assessed upon the mining concessions granted by the State to the taxpayer, fees or charges for governmental services in connection with mining and the Production Taxes which are declared in the Tax Laws to be laid upon the production of metals, metallic compounds and non-metallic ores.

D. The Court of Appeals' Analysis of the Production Taxes

Given the above-described system of taxation, the Court of Appeals rejected the notion that "the presence in the Mexican tax structure of an income tax law imports that the Production Tax is not an income tax." (*infra*, p. A-10) The Court described the tax thus:

> "The Mexican Production Tax is stated in the Mexican Mining Law of 1934 to be one laid 'on the production of metals' and 'on metal production.' It attaches when the ore is extracted from the sub-soil, irrespective of its sale or its transporation to a smelter or its further processing. The ores in the earth under Mexican law were part of the patrimony of the sovereign and, as taxpayer's expert testified, 'The miner takes them out of that deposit and puts them into the economic current of things, and thereby, to me, he creates wealth. His creation of wealth is what, in my opinion, is subject to the tax.'" (*infra*, pp. A-8—A-9)

The Court considered the point that the Production Tax was the equivalent of a tax on the proceeds of mining operations and as such a tax on gross income rather than on a return of invested capital, but met this point as it met all other points urged by petitioner with the assertion that the tax was "imposed on the privilege of extracting the ore irrespective of the realization of cash proceeds" (*infra*, p.

A-11). Conceding that *Stratton's Independence* v. *Howbert*, 231 U.S. 399, held that the entire proceeds of mining are income and conceding that this seemed to support the point that extracted ore is income in kind, the Court evaded the argument by saying that the *Stratton* case was considering an excise tax measured by income and concluded that:

> "By a parity of reasoning, we think the Supreme Court would hold that the Mexican Production Tax was an excise tax even though its measure was such as to reflect, at least approximately, 'the amount of benefit presumably derived' by the taxpayers from appropriating to themselves a portion of the national patrimony." (*infra*, pp. A-11—A-12)

Agreeing that under the statutory scheme of the Production Tax the tax rate applicable to the metal severed varies progressively with the price of the metal in the market, which obviously affects the miner's profit, the Court agreed too that the proofs established a legislative intent that the contribution of the mining industry to the national economy should vary with this price factor that affects the prosperity of the industry generally (*infra*, p. A-12). The Court, however, discarding the idea it had previously noted, that the severed ore was obviously gross income in kind, treated as significant the fact that the tax attached even if the miner did not sell the severed ore. Reverting to its assertion that the tax was a privilege tax, the Court stated that the progressive tax rates therefore betokened not an income character in the tax but an intention that the price of the privilege should be proportioned to the value of its exercise (*infra*, p. A-12). The Court similarly dealt with the fact that:

> "... the Production Taxes provide discounts for low grade ores, special discounts which recognize the extraordinary cost of extraction in the case of gold and silver found in zinc concentrates, and temporary discounts given to new and newly reopened mines the working of which involve extraordinary expense." (*infra*, pp. A-12—A-13)

It asserted that these too were factors which affected the value of the privilege and concluded:

> "Their presence in the tax scheme is not so much indicative of legislative intent to tax the miner's profits as of intent to realize, through a privilege tax, on a natural asset on a basis which at least approximately reflects its current value." (*infra*, p. A-13)

The Court did not deal in detail with the matter of classifying the Production Tax as a tax paid in lieu of a tax on income, but said:

> ". . . the reasoning which has lead [sic] us to classify the Production Tax as an excise, not an income, tax equally requires the conclusion that it has not been shown to be a tax 'in lieu of an income tax.'" (*infra*, pp. A-14—A-15)

The Court thus was evidently satisfied that the Production Tax was adjusted to profits. It based its whole conclusion on the theory that the tax was a "privilege" or "excise" tax simply because the nation which exacted the tax was the source of the miner's grant of right to extract the ore, which before his extraction of it formed a part of the patrimony of the taxing nation.* The Court said:

> "To us that means no more than that the Production Tax is one levied on the privilege of extracting from the sub-soil ore belonging to the nation." (*infra*, p. A-9)

Having concluded at the very threshold of its inquiry that the tax was a "privilege" tax or, as the Court later characterized it, an "excise" tax, the Court dispatched every economic element of the tax which demonstrated that the tax was in its economic consequence a true income or profits tax with the statement that such evidence showed only

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* Under Mexican law, as in Civil Law countries generally, mineral wealth in the subsoil remains the property of the nation until actually mined by the concessionaire. See 1 Lindley, Mines (3rd ed.) 21.

that the measure of the privilege tax was the value of the exercise of the privilege.

The Court, therefore, adopted as the determinant of its decision that often criticized distinction between the subject of a tax and the measure of a tax which has been worked out in this Court's decisions on the Corporation Tax Act of 1909 and in the cases involving the taxation of interstate commerce. With difficulty, we submit, the Court avoided its own decision in *New York & Honduras Rosario Mining Co.* v. *Commissioner,* 168 F.(2d) 745: the Court, while admitting that the Surface Tax which each Mexican miner pays was in fact a privilege tax, said that the fact that Mexican law imposed one privilege tax, the Surface Tax, did not import that the Production Tax or other taxes are not also privilege taxes—a difficult position for it to espouse in view of the Court's earlier statements in the *New York & Honduras* case (168 F.(2d) at pp. 747-748).

Reasons for Granting the Writ

I.

The decision of the Court of Appeals presents an important question of federal tax law which has not been but should be settled by this Court, that is, by what standard should the Courts determine the types of foreign taxes entitled to credit as income taxes or taxes in lieu of income taxes.

This Court has never interpreted the expressions "income taxes" and taxes "in lieu of income taxes" as found in the foreign tax credit provisions of the Internal Revenue Code.

The foreign tax credit has been before this Court on certiorari three times, but none of these cases tendered the present question.

> *Burnet* v. *Chicago Portrait Co.,* 285 U.S. 1 (1932);
> *Biddle* v. *Commissioner,* 302 U.S. 573 (1938);
> *American Chicle Co.* v. *United States,* 316 U.S. 450 (1942).

In the *Chicago Portrait* case, the question for decision was whether the state of New South Wales in the Commonwealth of Australia was a "foreign country" within the meaning of the statute. It appears that certiorari was granted because of the importance of the question to the administration of the revenue law. In holding that the credit was available for taxes paid to New South Wales, the Court in an opinion by Mr. Chief Justice Hughes emphasized the need for liberal construction of the foreign tax credit provisions to effect the underlying purposes of mitigating the evil of international double taxation and facilitating the foreign enterprises of domestic companies.

The second occasion upon which this Court reviewed the operation of the foreign tax credit was in *Biddle* v. *Commissioner*, 302 U.S. 573, in which certiorari was granted to resolve a "conflict of decision, and because of the importance of the question in the administration of the revenue laws." (302 U.S. at p. 578) The question was whether American stockholders of British corporations could claim that they were the taxpayers entitled to credit for the British income tax paid by the British corporations with respect to the profits they distributed to their American stockholders merely because the British income tax laws recognized that the burden of the corporate tax was borne by the shareholders. The taxes in controversy were not only disallowed as credits against United States tax, but were also disallowed as deductions from gross income since they were not the taxes of the American taxpayers at all.*

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* It will be noted that the taxpayer in the *Biddle* case was not seeking relief from any double taxation occasioned by his being subject to two taxing sovereigns, but rather from the same kind of "double taxation" sanctioned by our own laws, which imposed tax both upon a corporation and its stockholders (see 302 U.S. at p. 581). *Cf.* Section 34 of the Internal Revenue Code of 1954.

The third and final occasion upon which this Court has considered the operation of the foreign tax credit was in *American Chicle Co.* v. *United States*, 316 U.S. 450, where the sole matter in controversy was the proper method of computing the credit under Section 131(f) for taxes paid by a foreign subsidiary of a domestic taxpayer. Certiorari was granted to resolve a conflict of decisions in the lower courts (see 316 U.S. at p. 452). Again the issue of the types of foreign taxes for which credit may be taken was not considered.

The instant case presents, we believe for the first time, an appropriate record upon which the Court may render a decision of fundamental importance to the administration of the revenue law as to the types of foreign taxes for which credit may be taken.

Twenty-three years ago this Court, in order to effect the broad policy objectives of the foreign tax credit, held in the *Chicago Portrait* case that the State of New South Wales, Australia, was a "foreign country", saying:

> "The term 'foreign country' is not a technical or artificial one, and the sense in which it is used in a statute must be determined by reference to the purpose of the particular legislation." (285 U.S. at p. 6)

The language of the foreign tax credit has not since been broadly interpreted in the liberal spirit of this Court's decision in the *Chicago Portrait* case.

The Sixth Circuit in *Burroughs Adding Mach. Co.* v. *Terwilliger*, 135 F. (2d) 608, 610, disregarding the broad policy approach of the *Chicago Portrait* case, said:

> "The right to the credit claimed is a privilege granted by the Government, and hence the statute is to be strictly construed in favor of the Government."*

* Indicative of the confusion in the law is the fact that the same Court, without citing the *Burroughs* case, could say two years later in *Gentsch* v. *Goodyear Tire & Rubber Co.*, 151 F. (2d) 997, 1000:

"We think, therefore, that the controlling principle of statu-

The Second Circuit, in the *New York & Honduras Rosario Mining Co.* case (168 F. (2d) 745, 747) posited the question in these cases as being:

> "whether the foreign tax is the substantial equivalent of an 'income tax' as that term is understood in the United States".

Yet in the present case it applied not a test of equivalence in substance but a requirement of identity in theoretical form. *Keasbey & Mattison Co.* v. *Rothensies,* 133 F. (2d) 894, 898, both voiced the theory of the *Burroughs* case that the grant of the credit should be narrowly construed and adopted the highly theoretical "privilege" tax approach.

Similarly, the Tax Court, in *Northwestern Mutual Fire Association,* anticipating the Court below, rejected a Canadian tax on insurance premiums for credit purposes on the ground that it was a "privilege" tax* (12 T.C. 498, 505-506), but on appeal to the Ninth Circuit that Court allowed the credit, treating the Canadian premium tax as a tax *in lieu* of an income tax on the ground that a not dissimilar premium tax existed in the income tax part of our own Internal Revenue Code (181 F. (2d) 133).**

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tory construction is not that which requires special tax exemptions to be strictly construed, but rather the principle so often announced as not to require citation, that statutes must be so construed as to give effect of their general purpose and to implement the policy of the Congress."

* Again indicative of the prevalent confusion is the fact that earlier the Commissioner voluntarily accorded the credit to the Canadian premium tax as an income tax. See *United States Fidelity & Guaranty Co.,* 5 B.T.A. 23.

** The variety of "income taxes" embraced in our history of income taxation is broad and includes the Silver Purchase Tax (Silver Purchase Act of 1934, 48 STAT. 1178), considered by this Court in *United States* v. *Hudson,* 299 U.S. 498, and the Tax on Unjust Enrichment (Internal Revenue Code of 1939, Sections 700-705). See *Wilson Milling Co.,* 1 T.C. 389, affirmed 138 F. (2d) 249, cert. den. 320 U.S. 800.

Cf. Opinion of the Justices, 84 N.H. 557, 558, 149 Atl. 321, 334, considering a proposed tax on the annual increment in value of standing timber to be in the nature of an income tax.

The intimation is that even a tax imposed in lieu of an income tax might be required to evince the characteristics of an income tax.

The importance of preserving to the foreign tax credit its strongly marked policy characteristic has never been greater than in this time of encouraging American private enterprise to make substantial investments abroad.* In the year 1951 the 2,726 American corporations which claimed credit for foreign taxes on Form 1118, derived income from foreign countries (according to their income tax returns) in the amount of $1,745,529,000; these companies paid $619,796,000 in foreign taxes for which credit was claimed, and the amount of the foreign tax credit claimed in respect of such payments was $571,905,000.** 1,033 of the 4,822 corporations returning more than $1,000,000 of income in 1951 claimed credit for foreign taxes.*** The foreign tax credit thus affects very large amounts of foreign earnings and a remarkably high percentage of our larger tax-paying corporations.

The high rate of corporate income tax must make the credit status of taxes in foreign countries a significant determinant of private investment in foreign countries.† The practical feasibility of embarking on a program of investment in a foreign country cannot, we submit, be made to depend on private scrutiny of the tangled web of adjudication on the theoretical nature of taxes as privilege or excise or direct or indirect taxes. A clear policy pronouncement by this Court on the proper interpretation of the nature of the credit is a pragmatic necessity.

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* Message of President Eisenhower to Congress, The New York Times, January 11, 1955, p. 16, col. 3; COMMISSION ON FOREIGN ECONOMIC POLICY, REPORT TO THE PRESIDENT AND THE CONGRESS (1954), p. 16, *et seq.*

** Statistics of Income for 1951, Part 2, Corporation Income Tax Returns, p. 24 (United States Treasury Department, Internal Revenue Service, Statistics Division).

*** Ibid, pp. 18, 25.

† COMMISSION ON FOREIGN ECONOMIC POLICY, REPORT TO THE PRESIDENT AND THE CONGRESS (1954), p. 18.

II.

In the decision of an important question of federal tax law, the Court of Appeals invoked a body of constitutional precedent in this Court irrelevant and inappropriate to the interpretation of the foreign tax credit and in so doing misinterpreted and misapplied the precedents in this Court which it invoked.

The Court of Appeals treated an income tax as the antithesis of a "privilege" or "excise" tax and concluded that because, in its view, the Production Tax was a privilege or excise tax, it was not an income tax and therefore could not be accorded credit under Section 131. The Court relied on the subject and measure concept applied in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, and *Stratton's Independence* v. *Howbert*, 231 U. S. 399. It considered that the "subject" of the tax was the privilege of extracting from the subsoil ore belonging to the nation. It conceded that the "measure" of the tax was "such as to reflect, at least approximately, the amount of benefit presumably derived by the taxpayers from appropriating to themselves a portion of the national patrimony" and that aspects of the Production Tax indicated a legislative intention to tax according to profitability (*infra*, pp. A-11—A-12). The Court said that this betokened only an intention that the price of the privilege granted the miner should "vary with the value of the privilege measured both by the loss of the ore to the state which grants the privilege and the acquisition of the ore by the miner" (*infra*, p. A-12).

But the legal principles involved in the "subject" and "measure" analysis of taxes are addressed to the existence of constitutional immunities of particular "subjects" of tax from all taxation. See *Society for Savings* v. *Bowers*, 349 U. S. (May 16, 1955). They were evolved under the constitutional necessity of recognizing immunities from taxation without permitting the existence of the immunities to

impinge on lawful powers to tax. Thus, for example, a tax, the economic burden of which was "measured" by a class of income or receipts immune from tax, would not be invalidated if the true "subject" of the tax was a privilege or activity that the state had general power to tax. *Educational Films Corp.* v. *Ward*, 282 U. S. 379; *Ficklen* v. *Shelby County Taxing District*, 145 U. S. 1. But if the "subject" taxed was one immune from the general taxing power of the particular sovereign involved, the mere fact that the values that "measured" the economic burden of the tax might themselves have been a proper "subject" of the tax would not cure the essential vice of the tax. *Spector Motor Service, Inc.* v. *O'Connor*, 340 U. S. 602. Compare *West Publishing Co.* v. *McColgan*, 328 U. S. 823. So, the United States having been held powerless to impose a general income tax, this Court, invoking the subject and measure distinction, sustained the Corporation Tax Act of 1909 as an excise tax on doing business in corporate form measured by income—although the United States had not granted and could not effect forfeiture of the right to do business in corporate form.

The majority of this Court in the *Spector* case emphasized the purely constitutional significance of the subject and measure distinction in these words:

> "Even though the financial burden on interstate commerce might be the same, the question whether a state may validly make interstate commerce pay its way depends first of all upon the constitutional channel through which it attempts to do so." (340 U.S. at 608)

But this body of law, founded in constitutional necessities, is characterized by debate and distinction which petitioner respectfully suggests are entirely inappropriate to the interpretation of the foreign tax credit. Indeed a minority of this Court have indicated that they are not prepared to recognize the distinction between subject and measure even in the constitutional field and have stated

their position to be that it was the "'privilege' label that condemned the tax" in the *Spector* case. *Railway Express Agency* v. *Virginia*, 347 U. S. 359, 370. And this Court has divided on the ascertainment of the privilege which is truly the subject of a particular tax. *Interstate Pipe Line Co.* v. *Stone*, 337 U. S. 662.

The difficult and important problems of principle involved in adjusting the interplay of forces coming into conflict at the level of constitutional power have nothing in common with the simple problem of giving effect to the plain economic policy of a direct grant of relief from double taxation. The foreign tax credit is oriented to the economic realities of taxation and the grant should not be frustrated in achieving the objectives of encouraging foreign investment and eliminating double taxation by introducing conceptual distinctions irrelevant to the objectives of the statute.

The Court of Appeals chose to follow the decision of the Third Circuit in *Keasbey & Mattison Co.* v. *Rothensies*, 133 F.(2d) 894* in relying on the "privilege tax" distinction (*infra*, p. A-10). The Third Circuit stated its authority for distinguishing a "privilege tax" from an "income tax" in the *Keasbey* case in this way:

> "The Supreme Court, without advancing any precise definition of the term 'income tax', has unmistakably determined that taxes imposed on subjects other than income, e.g., franchises, privileges, etc., are not income taxes, although measured on the basis of income. *Stratton's Independence, Ltd.* v. *Howbert*, 231 U.S. 399, 34 S. Ct. 136, 58 L.Ed. 285; *McCoach* v. *Minehill & S. H. R. Co.*, 228 U.S. 295, 33 S. Ct. 419, 57 L. Ed. 842; *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 31 S. Ct.

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* The taxpayer's petition for certiorari was denied in the *Keasbey* case (320 U. S. 739). Contrary to the record upon which the present action is proffered to the Court, the record in the *Keasbey* case consisted of the bare language of the Quebec statute, furnishing no basis for an appraisal of the operation and economic burden of the tax.

342, 55 L. Ed. 389, Ann. Cas. 1912B, 1312; *Spreckels Sugar Refining Co.* v. *McClain,* 192 U.S. 397, 24 S. Ct. 376, 48 L. Ed. 496; see: *Doyle* v. *Mitchell Bros. Co.,* 247 U.S. 179, 183, 38 S. Ct. 467, 62 L. Ed. 1054; *United States* v. *Whitridge,* 231 U.S. 144, 147, 34 S. Ct. 24, 58 L. Ed. 159." (Italics supplied.) (133 F. (2d) at p. 897)

All the cases cited (except the *Spreckels* case) arose under the Corporation Tax Law of 1909 which this Court thus characterized in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107:

> "It is therefore apparent, giving all the words of the statute effect, that the tax is imposed not upon the franchises of the corporation irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate or insurance business and with respect to the carrying on thereof, in a sum equivalent to one percentum upon the entire net income over and above $5,000 received from all sources during the year; that is, when imposed in this manner it is a tax upon the doing of business with the advantages which inhere in the peculiarities of corporate or joint stock organizations of the character described." (at p. 145-146)

The alien formalism of this language, however necessary to the solution of the constitutional problem then before the Court, plainly has no place in the administration of the foreign tax credit.

The conclusion drawn by the *Keasbey* case from its consideration of the cases it cited was that:

> "The substantive elements of the tax under consideration conform, not to the recognized criteria of an income tax, but, to the accepted standards of an excise tax." (133 F.(2d) at p. 898)

And the Court of Appeals in the present case treated the tax as an "excise, not an income, tax" (*infra,* p. A-14).

An income tax is an excise tax in every instance of its application except where it falls upon income derived from

property merely by virtue of ownership, as, for example, upon the interest from bonds or the rents from real estate. That was the whole point of the decision in *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, invalidating the early income tax and of *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S. 1, sustaining the 1913 income tax.

Spreckels Sugar Refining Co. v. *McClain*, 192 U. S. 397, cited in the *Keasbey* case, emphasized in this language the excise nature of income taxes:

> "This general question has been considered in so many cases heretofore decided that we do not deem it necessary to consider it anew upon principle. It was held in *Pacific Insurance Co.* v. *Soule*, 7 Wall. 433, that the income tax imposed by the internal revenue act of June 30, 1864, amended July 13, 1866, 13 Stat. 223, 14 Stat. 98, on the amounts insured, renewed and continued by insurance companies, on the gross amount of premiums received, on dividends, undistributed sums and income, was not a direct tax, but an excise duty or tax within the meaning of the Constitution; . . ." (192 U. S. at pp. 411-412)

The Court explained the *Farmers' Loan & Trust Co.* case in this way:

> "It is said that if regard be had to the decision in the *Income Tax Cases*, a different conclusion from that just stated must be reached. On the contrary, the precise question here was not intended to be decided in those cases. For, in the opinion on the rehearing of the *Income Tax Cases* the Chief Justice said: 'We have considered the act only in respect of the tax on income derived from real estate, and from invested personal property, and have not commented on so much of it as bears on gains or profits from business, privileges or employments, in view of the instances in which taxation on business, privileges or employments has assumed the guise of an excise tax and been sustained as such.' 158 U.S. 601." (192 U.S. at p. 413)

Thus the Court below fundamentally misconstrued the decisions it sought to apply in reaching the conclusion that "excise" taxes are the antithesis of "income" taxes.

The standards appropriate to testing the availability of the foreign tax credit are those which seek to determine whether the foreign tax has the fiscal characteristics of an income tax, that is, that the tax falls upon gross income in contrast to gross receipts (whether or not deductions from gross income are also allowed), is generally insusceptible to being passed on to others than the taxpayer, and is proportioned to capacity to pay, through the use of a progressive rate structure or otherwise.

The Court of Appeals in adopting the test it did adopt, and in misapplying that test, rendered a decision of great importance in the field of federal income taxation and rendered that decision in a way that is in conflict with decisions of this Court.

Conclusion

Two of the Courts of Appeals, relying essentially on this Court's decisions under the Corporation Tax Act of 1909, have characterized foreign taxes as being "excise" or "privilege" taxes and on that ground have denied them the foreign tax credit accorded to income taxes. The necessary effect of the decisions is to restrict the scope of the credit without reference to the practical measure of the foreign tax or its entire suitability for credit from the point of view of the policy of the statute. Profits are doubly taxed and foreign investment is correspondingly discouraged whether the foreign tax falls upon profits as the "subject" of the impost or as the "measure" of

its burden. Under either circumstance income bears a double tax.

Only review by this Court can furnish authoritative guidance to the Courts of Appeals and the Tax Court in the interpretation of the foreign tax credit and restore to the credit a breadth of meaning adequate to the accomplishment of its policy.

Respectfully submitted,

NORRIS DARRELL,
JOHN F. DOOLING, JR.
ROBERT MACCRATE,
Attorneys for Petitioner.

SULLIVAN & CROMWELL,
Of Counsel.

June 13, 1955.

APPENDIX A

Judgment

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 15th day of March, one thousand nine hundred and fifty-five.

Present:

HON. HARRIE B. CHASE,
HON. HAROLD R. MEDINA,
HON. CARROLL C. HINCKS,
Circuit Judges

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

THE AMERICAN METAL CO.,
Respondent.

THE AMERICAN METAL CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

/s/ A. DANIEL FUSARO
Clerk.

Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 29 October Term, 1954

Argued November 4, 1954 Decided March 15, 1955

Docket No. 22907

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

THE AMERICAN METAL CO., LIMITED,
Respondent.

THE AMERICAN METAL CO., LIMITED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before CHASE, MEDINA and HINCKS, *Circuit Judges.*

Petition by taxpayer to review a decision of the Tax Court of the United States which denied it a credit against its 1947 United States Income Tax liability for taxes paid to the Republic of Mexico under that nation's Mining Tax Laws. Petition of the Commissioner of Internal Revenue to review so much of the same decision of the Tax Court as denied his claim that in computing the amount of the credit allowable for taxes paid to Mexico the taxes so paid should be discounted to reflect the peso-dollar rate of exchange prevailing in the taxable year. 19 T.C. 870. *Affirmed.*

Sullivan & Cromwell (Norris Darrell, John F. Dooling, Jr., Robert MacCrate, of counsel) for *The American Metal Company, Limited.*

H. Brian Holland, Assistant Attorney General, Ellis N. Slak, Lee A. Jackson, Melva M. Graney, Special Assistants to the Attorney General, for the *Commissioner of Internal Revenue.*

HINCKS, *Circuit Judge*:

The taxpayer whose petition is before us, is a New York corporation which owns over 98% of the voting stock of Compania Minera de Penoles, S.A., a Mexican corporation (hereinafter referred to as "Minera"). Minera, from 1924 through 1947, has been in the business of mining, milling, smelting and refining non-ferrous metals. In 1934, the smelting and refining operations were carried on by a Mexican corporate subsidiary of Minera, called Metalurgica. In 1947, Minera paid a taxable dividend to its shareholders in United States money in the amount of $8,250,000. Of this amount the taxpayer received $8,110,932.50. The taxpayer filed a consolidated income tax for the year 1947 claiming as credit certain Production Taxes paid by Minera to the Mexican government from 1924 through 1947. The Commissioner allowed a credit for taxes paid by Minera under the Mexican Income Tax Law but refused to allow any credit for the payment to Mexico of so-called Production Taxes as imposed by the Mexican Mining Tax Law.

The taxpayer's petition presents this question: Were the Production Taxes paid by Minera under the Mexican Mining Tax Law income taxes or taxes in lieu of income taxes within the meaning of Section 131(a)(1) or (h) of the Internal Revenue Code? Only if the question requires an affirmative answer is the taxpayer entitled to the credit which it seeks by its pending petition to establish.

In a well reasoned opinion, the Tax Court held that the Production Taxes in question were not income taxes or

taxes in lieu of income taxes within the meaning of I. R. C. Section 131(a)(1) or (h).[1] The taxpayer-petitioner now contends that this holding was erroneous in that the court failed to find and give effect to facts claimed to be fully established by the evidence as follows:

> "Mining is in Mexico a main source of the national economy. Under Mexican law, the mineral wealth of the nation is the property of the nation and not of the landowner. The landowner in Mexico has no right to the minerals under his land nor to explore for them; only the one who has received a mining concession from the Government can explore for minerals.
>
> "While the miner in Mexico derives his right to mine by Government concession, that concession confers upon him no ownership in metals or minerals in the earth but only the right to explore for them, and when he has discovered them to turn them to his own account or profit by removing them from the subsoil. This is so far true that if a mining concessionnaire forfeits or surrenders his mining concession,

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1. I.R.C. Section 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.* If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102, shall be credited with:

(1) *Citizens and Domestic Corporations.* In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States;

* * * * *

(h) *Credit for Taxes in Lieu of Income, etc., Taxes.* For the purpose of this section and section 23(c) (1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States.

* * * * *

ore that he has broken and left inside the mine is not his property but reverts to the Government of Mexico as its property.

"Customarily, the Mexican miner sells his ore to a smelter or foundry and sells it on the basis of the current New York price of the recoverable metal content of the ore less processing, transportation and commission costs and less the Production Taxes (which are also based on the New York price). The New York price is normally determined by world supply and demand and not by the Production Taxes nor by the Mexican miner's costs which vary from mine to mine between wide extremes.

" 'Commercial ore' is material, the value of the recoverable and salable metal of which is such as to yield more than the costs necessary to get the metals in available form.

"Hence, whether a mine will be opened up at all, depends upon the estimated value of the salable metals recoverable from the ore weighed against the estimated cost of working the particular metal-bearing body, including the cost of the property, of opening the mine, and of equipping and operating it and taking into account also the grade of the ore body, the uniformity of that grade, the size of the ore body, its location with relation to transportation facilities, treatment plants and natural land barriers and the type of mining possible with that ore body. Existing mines which have been once opened and worked are not continued in operation unless metal prices are such as to make operation profitable, and declines in market prices of metals result in shutting down mines, while increases in metal prices bring mines that have been shut down back into operation.

"Broadly, price determines whether there is commercial ore in a mine and whether and how long and

when the mine will operate. The market prices of the metals occurring in Minera ores varied widely over the years 1924 to 1947; lead ranged from 3¢ a pound to 15¢ a pound, zinc from 2.55¢ a pound to 10½¢ a pound, silver from 25.01¢ an ounce to 90.12¢ an ounce, and copper from 4.91¢ a pound to 22.19¢ a pound. Mining costs, on the other hand, at any point of time, vary widely from mine to mine and in particular vary widely as among the metal mines in Mexico, the variation depending on the type of ore body and the feasible rate of mining, among many other factors.

"Within a single mine where ore of varying grades is found, the richest ore will always be mined first even in an era of abnormally high prices which would enable the miners to extract at a profit those leaner ores in the same mine that could not be mined at a profit when normal metal prices prevail. It is a principle in mining, and a prevalent practice in the industry, that the miners extract the high grade ores first and as quickly as they can up to the limit of their milling capacity and do not in a period of high prices divert to low grade ores.

"Miners do not, in principle, extract ore at all when it cannot be disposed of at a profit, unless some special physical condition makes that imperative and unless they can afford to store the extracted ore pending an expected rise in the market price. Nor are mines generally operated when prices are believed to be temporarily depressed merely because a narrow profit margin appears to be possible at those prices, particularly if the mine is a new one. In such circumstances, the mine would be shut down until prices increased. And so, too, as to opening a new mine, a mine will not be opened up on the basis of a price level believed to be only temporary, for it takes three to five years to open a mine. On the other hand,

metallurgical advances, alone or coupled with price advances, can give minable character to ore once passed over as waste.

"Since a mine is a wasting asset, the life of which is exhausted by extraction of the ore, it is basic in mining that ore will not be removed from the mine at a loss when prices are low."

As to so much of this material not incorporated in the express findings of the Tax Court, we think it fairly apparent from its opinion that it treated all the facts just recited as proved and gave due consideration thereto. However that may be, we will assume for present purposes that the facts above stated were indeed proved. But even on that assumption we hold that the decision of the Tax Court was correct.

The primary objective of Section 131 is to prevent double taxation and a secondary objective is to encourage American foreign trade. See *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1. Whether the special and peculiar facts of a given case comes within the meaning of 131(a)(1) or (h) is a question to be determined in the light of the established and settled policy against double income taxation. The pertinent cases hold that the determinative question is "whether the foreign tax is the substantial equivalent of an 'income tax' as that term is understood in the United States." See *New York & H. Rosario Min. Co.* v. *Commissioner*, 2 Cir., 168 F. 2d 745, 747; *Biddle* v. *Commissioner*, 302 U. S. 573; *Keasbey & Mattison Co.* v. *Rothensies*, 3 Cir., 133 F. 2d 894.

The Mexican Production Tax is stated in the Mexican Mining Law of 1934 to be one laid "on the production of metals" and "on metal production." It attaches when the ore is extracted from the sub-soil, irrespective of its sale or its transportation to a smelter or its further processing. The ores in the earth under Mexican law were part of the patrimony of the sovereign and, as taxpayer's expert testi-

fied, "The miner takes them out of that deposit and puts them into the economic current of things, and thereby, to me, he creates wealth. His creation of wealth is what, in my opinion, is subject to the tax." To us that means no more than that the Production Tax is one levied on the privilege of extracting from the sub-soil ore belonging to the nation.

The taxpayer points, on the one hand, to the Mexican Mining Law of 1926 which "restored the ancient work requirement and made it a condition to the continuance of the concession * * * while continuing the Surface Tax in effect," and to the Mining Law of 1934 which from that time forward conditioned the continuance of the miner's "concession on the dual requirement of paying the Surface Tax and working the mine." And, on the other hand, the taxpayer points to the fact, which we accept as proved, that the payment of an accrued Production Tax is *not* a condition to the continuance of the miner's concession. From this it is argued that the Production Tax is not a privilege tax because the Mexican Mining Law imposes as the price of the miner's privilege "the performance of the work requirement and the payment of the Surface Tax."

We think this argument specious. Forfeiture of the privilege for non-payment is not the exclusive badge of a privilege tax. Whether, for present purposes, the Production Tax is a privilege tax must depend not upon forfeiture conditioned on non-payment nor upon the absence of label in the enacting law,—but upon the nature and effect of the tax. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107. Indeed the Surface Tax, which is imposed by Chapter II of the Mining Law and which the taxpayer for purpose of this argument seems to classify as a privilege tax is not so labelled. It is based on the area of the concession: for a concession exceeding one hundred claims it imposes a tax of only $15 annually per claim. And the "work requirement," which constitutes the other condition to the con-

cession, is described by taxpayer's expert in Mexican law as the subject-matter of ordinances requiring "that four men at least should be employed for a minimum time during each year working in the mine." The mere fact that the miner's concession is thus conditioned on a "price" based on area and a minimum work requirement does not mean that the Production Tax, which is based "on the production of metals" in the ore belonging to the sovereign which the miner extracts and thereby is allowed to appropriate, is other than a privilege tax.

In this connection, the taxpayer relies on our decision in *New York & H. Rosario Min. Co.* v. *Commissioner*, 168 F. 2d 745. It is true that in that opinion we thought it "not without significance" that under the Honduras Mining Code genuine excise taxes, somewhat similar to the Mexican "Surface Tax," were imposed in addition to the "income tax" also imposed. However, the determinative factor which lead us to classify the tax there in question as an "income tax", we stated as follows: "It is not laid on the value of the minerals mined but on 'the amount received from its exports,' i.e. gross income, less operating expenses within Honduras and expenses abroad directly applicable to management of the mines, plus reasonable deductions for amortization and depletion." The characteristics of the Production Tax here involved are essentially antithetical to those of the Honduran income tax. And the fact that ore belonging to the nation is released to the miner who is subject to the tax forthwith upon the extraction of the ore, marks the Mexican Production Tax more clearly and certainly as a privilege tax than the Quebec tax which was held to be an excise tax in *Keasbey & Mattison Co.* v. *Rothensies*, 3 Cir., 133 F. 2d 894, cert. den. 320 U.S. 739, which cites numerous cases which lend still further support to our conclusion.

The fact that Mexican law imposes one privilege tax, the Surface Tax, no more imports that the Production Tax

or other taxes are *not* also privilege taxes than the presence in the Mexican Tax structure of an income tax law imports that the Production Tax is not an income tax.

Our conclusion is not shaken by the taxpayer's ingenious argument that in effect the Production Tax is the equivalent of a tax on the proceeds of mining operations. The argument is based upon American cases which hold, for purposes of domestic taxation, that the *proceeds* of mining constitute gross income as distinguished from a return of invested capital. We think such cases wholly irrelevant to the problem here presented. For the Mexican Production Tax is *not* imposed on the proceeds of mining. Again it is necessary to point out that it is imposed on the privilege of extracting the ore irrespective of the realization of cash proceeds.

In this connection the taxpayer relies especially on *Stratton's Independence* v. *Howbert*, 231 U. S. 399, in which the court was concerned with our federal Corporation Tax Law of 1909 which imposed an excise tax on the privilege of doing business in a corporate capacity, the tax being measured by the taxpayer's "entire net income" as defined. As the taxpayer here points out, the court did indeed hold that the entire proceeds of mining were income without deduction on account of the value of the ore *in situ* which after extraction had been converted into proceeds. In this aspect the case seems to support the argument that extracted ore is income in kind irrespective of its realization as cash income. But the taxpayer seems to overlook the fact that that tax, enacted in 1909 prior to the Sixteenth Amendment, was sustained as an *excise* tax and not as an income tax over the contention that in effect it was the "equivalent to a direct tax on property, and hence unconstitutional." The court held that the tax was none the less an excise tax because Congress, in adopting "income as the measure of the tax * * * desired that the excise should be imposed, approximately at least, with regard to the amount of benefit pre-

sumably derived by such corporations from the current operations of the Government." By a parity of reasoning, we think the Supreme Court would hold that the Mexican Production Tax was an excise tax even though its measure was such as to reflect, at least approximately, "the amount of benefit presumably derived" by the taxpayers from appropriating to themselves a portion of the national patrimony. Thus the real thrust of the case is destructive of this branch of the taxpayer's argument.

The taxpayer further contends that the Production Taxes are income taxes "of a formulary kind." He argues that the Production Tax is characterized as an income tax at least in part because of its "profit objective" as affecting the mining industry. It is true that under the statutory scheme the rate of tax applicable to the metal severed varies progressively with the price of the metal in the world market. Since obviously the price of the metal affects the miner's profit we agree that the proofs establish a legislative intent that the contribution of the mining industry to the national economy should vary with a factor which affects the prosperity of the industry generally. Let it be granted that the state in fixing the tax rates sought to obtain as much tax income as could be done without killing the goose that laid the golden egg. Nevertheless, this does not mean that the Production Tax is one on the profits of the miner. For as already noted it attaches even if the individual miner makes no profits,—even if, having severed the ore, he makes no sales. More truly, we think, this incident of the tax scheme betokens an intent that the price of the privilege granted the miner shall vary with the value of the privilege measured both by the loss of the ore to the state which grants the privilege and the acquisition of the ore by the miner. Merely because the state charges more for the release of its ore when the value thereof is high does not mean that the charge is a tax on the miner's profits.

The taxpayer seeks further to buttress this line of argument by pointing to the fact that the Production Taxes provide discounts for low grade ores, special discounts which recognize the extraordinary cost of extraction in the case of gold and silver found in zinc concentrates, and temporary discounts given to new and newly reopened mines the working of which involve extraordinary expense. But these, too, are factors which affect the value of the privilege. Their presence in the tax scheme is not so much indicative of legislative intent to tax the miner's profits as of intent to realize, through a privilege tax, on a natural asset on a basis which at least approximately reflects its current value.

Nor has the taxpayer succeeded in demonstrating that the Production Tax is a "formulary" income tax because it "compliments" the Mexican Income Tax law. It is true, as it points out (although in another connection), that the overall tax scheme of Mexico includes an income tax,—one which satisfies the American concept of an income tax. Schedule I of this tax law taxes income derived from capital and personal effort invested in industry, commerce and agriculture; income from personal effort being taxed at the lowest rate, income from investments at the highest rate, and income from combined capital and labor at an intermediate rate. The tax under this Schedule is a tax on gross income less authorized deductions but although applicable to miners—as are also Schedules II and III—allows no deductions for depletion. Furthermore, we accept as proved the taxpayer's assertion that except for mining enterprises the tax under Schedule I is imposed at a higher rate on businesses which require a concession from the state. If on such facts it had been shown that the impact of the Production Tax on miners was substantially the same as the differential between the income tax on miners and the income tax on other industries operating under government concessions or even that the Production Tax was imposed to equalize this differential in the income tax law, there would be more room for the conclusion that the Production

Tax was what taxpayer calls a "formulary" income tax within the reach of the holding in *Seatrain Lines* v. *Commissioner*, 46 B. T. A. 1076, which the taxpayer cites to the point.

But such evidence is lacking here. At most, we have the conclusion of the taxpayer's Mexican tax expert that the special tax rate provided by Schedule I for application to business operating under government concessions was not made to apply to businesses enjoying a mining concession "because it is deemed that those concerns, mining concerns pay an *additional* tax which is *complimentary* of the income tax." (Emphasis supplied.) This, we think, wholly inadequate to bring the Production Tax within the *Seatrain* doctrine even assuming, as we do, that the "additional tax" to which the expert referred was the Production Tax. This vague language of the expert, we think, may not be taken as proof that the Production Tax was substantially effective or even designed to equalize differentials in the impact of Mexican laws taxing income or to serve administrative convenience in the computation of a tax on income. It is by no means clear to us that by "complimentary" the taxpayer's expert meant any more than "additional" or supplementary. However that may be, such conclusionary testimony is inadequate to support the taxpayer's contention that the Production Tax has the essential characteristics of our American income tax. Certainly it is vitally different from the Cuban Tax with which the *Seatrain* case was concerned. And *Keen* v. *Commissioner*, 15 B. T. A. 1243, which taxpayer also cites to this point, we think in conflict with the later decision of the Supreme Court in *Biddle* v. *Commissioner, supra.*

What has been said, we think, sufficiently disposes of taxpayer's final contention that the Production Tax is at least one "paid in lieu of a tax on income" within the meaning of that provision of the Revenue Act of 1942 which is now incorporated in I. R. C. Section 131(h). We

do not need to decide whether, as taxpayer claims, Regulation 111, Section 29.131-2 is unduly restrictive of the 1942 amendment, the liberalizing objective of which we fully recognize. For the reasoning which has lead us to classify the Production Tax as an excise, not an income, tax equally requires the conclusion that it has not been shown to be a tax "in lieu of an income tax." We so hold.

This brings us to the Commissioner's petition to review the holding of the Tax Court that the credit to which the taxpayer was concededly entitled on account of Minera's payment of income taxes to Mexico in past years had not been improperly computed in that, in the computation, said tax payments had not been discounted to reflect the rate of exchange prevailing in 1947 when Minera's dividend was paid to the taxpayer.

The Commissioner takes the position that Section 131(a), which creates the credit, allows it only to the extent of "the amount of any income * * * taxes paid * * * during the taxable year to any foreign country * * *." He contends that in so providing Section 131 creates a statutory presumption that the income taxes paid by Minera in prior years were paid by the taxpayer *in the taxable year*. This, he contends, requires that, in computing the credit allowable in this case, the taxes paid by Minera to Mexico in pesos in former years should be discounted to reflect the rate of exchange prevailing in the taxable year when the dividend was paid.

I. R. C. 131, which in paragraph (a)(1) authorizes the credit, contains in paragraph (f)(1) thereof[2] the formula

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2. I.R.C. Section 131.

* * * * *

(f) *Taxes of foreign subsidiary.*

(1) *Foreign subsidiary of domestic corporation.* For the purpose of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any

for its computation in cases in which a domestic taxpayer corporation shall have received dividends in any taxable year from a foreign subsidiary corporation which has paid income taxes to a foreign country. The formula provides that the domestic corporation "shall be deemed to have paid the same proportion of any income * * * taxes paid * * * by such foreign corporation * * *, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits." Paragraph (f) further provides that the dividend paid by the foreign subsidiary shall be treated "as having been paid from the accumulated profits of the preceding *year or years*" and "as having been paid from the most recently accumulated gains, profits, or earnings" of the foreign subsidiary. Thus paragraph (f) clearly imports that the allowable credit is not restricted to foreign taxes paid by the subsidiary *in the taxable year* in which the dividend was received by the domestic parent. Instead, the credit is measured by a defined proportion of the foreign income taxes paid upon "the *accumulated profits* of such foreign corporation *from which such dividends were paid.*" Consequently, foreign income taxes paid in prior years may be reflected in the allowable credit if they had been imposed on

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foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings.

the accumulated profits from which the dividend was deemed to have been paid. We do not understand the Commissioner to dispute this: his contention is limited, as above indicated, to the method of computing the credit for the foreign income taxes paid in prior years.

It seems to us that the gist of the formula of paragraph (f) is the prescribed relationship between the *foreign tax paid* by the foreign subsidiary and its *accumulated profits* from which the dividend was paid and upon which the tax paid was imposed as that relationship existed when the taxes were paid and the profits were deemed to have been accumulated; and that, in the case of a foreign subsidiary conducting its business in foreign currency for purposes of computing the credit under Section 131 both these factors of the relationship must be expressed in terms of the same currency. If that be done, it will not affect the result whether the rate of exchange be that prevailing when the foreign tax was paid and the relevant profits accumulated or that prevailing when the dividend was paid by the foreign subsidiary to its domestic parent.

However, that problem is not presented here. Minera's dividend to the taxpayer was paid in dollars and throughout all the years involved it conducted its business on the basis of the American dollar. Not only were its profits accumulated on that basis but also the taxes which it paid to Mexico. It is true that its tax payments to Mexico were made in pesos but the pesos used for this purpose, like pesos expended for other purposes, were obtained by converting American dollars into pesos at the contemporary rate of exchange. And such income items as it received in pesos were similarly converted into dollars and so recorded on its books. As a result, we fully agree with the Tax Court that no problem in foreign exchange is presented which requires solution for the computation of the allowable credit.

We conclude that the Tax Court was right in its decision of the questions raised by both petitions.

Affirmed.

Findings of Fact and Opinion

19 T. C. No. 106

THE TAX COURT OF THE UNITED STATES

THE AMERICAN METAL COMPANY, LIMITED,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 31547.

Promulgated February 20, 1953.

CREDIT FOR FOREIGN TAX—MEXICAN MINING TAX LAWS—PRODUCTION TAX—SECTION 131(a)(1) and (h).—The production taxes imposed by the Mexican Mining Tax Laws do not constitute income taxes or taxes in lieu of income taxes within the meaning of section 131(a)(1) or (h) of the Internal Revenue Code.

CREDIT FOR FOREIGN TAX—EXCHANGE RATES.—No foreign exchange problem arises in ascertaining the amount of credit for foreign taxes paid by the foreign subsidiary of a domestic taxpayer where the foreign subsidiary at all times kept its books so that tax payments, earnings and dividends were reflected exclusively in the equivalent of United States currency.

JOHN F. DOOLING, JR., Esq., and ROBERT MACCRATE, Esq., for the petitioner.

CONWAY N. KITCHEN, Esq., for the respondent.

The Commissioner determined a deficiency of $2,180,517.99 in the income tax of the petitioner based upon a con-

solidated return for 1947. The petitioner raises but one issue for decision and that is whether mining production taxes imposed by the Republic of Mexico constitute income taxes or taxes in lieu of income taxes within the meaning of section 131(a)(1) or (h) so as to entitle the petitioner to the credit provided in section 131(f)(1). The only other issue for decision is that raised by the Commissioner in an amended answer in which he claims that any credit allowed under section 131(f) for income taxes or production taxes paid to the Republic of Mexico should be computed by converting the foreign taxes measured in pesos to American dollars at the rate of exchange existing at the time of the declaration of the dividend rather than at the rates of exchange existing at the times when the taxes were paid. He claims the increase in the deficiency which would result.

FINDINGS OF FACT

The petitioner, a New York corporation organized in 1887, filed a consolidated income tax return for 1947 with the collector of internal revenue for the Second District of New York. The return reported income of the petitioner for itself and a number of affiliated companies.

Compania Minera de Penoles, S. A., hereafter referred to as Minera, was a Mexican corporation organized in 1887. The petitioner owned a majority of the voting stock of Minera at all times material hereto. Minera did not join in the consolidated return.

Minera was engaged in Mexico, directly and through subsidiaries from 1924 through 1947, in mining ores of non-ferrous metals and of milling a portion of those ores, and until March 14, 1934 was also engaged in smelting and refining non-ferrous metals. It also smelted and refined during the latter period some ores and concentrates which it purchased. It transferred its smelting and refining operations on March 14, 1934 to a subsidiary Mexican corpo-

ration herein called Metalurgica. The ores and concentrates produced by Minera contained metals not recovered through the smelting and refining operations but which passed into "secondaries." Those secondaries, during the years 1924 through 1947, were further refined through treatment at plants of corporations other than Minera and Metalurgica in order to recover the metals contained therein.

Minera paid a taxable dividend to its shareholders in 1947 in United States money in the amount of $8,250,000 of which the share received by the petitioner was $8,110,932.50. The petitioner included the latter amount in income on the consolidated return for 1947 and chose to have the benefits of section 131 of the Internal Revenue Code. The credit claimed in that return (as limited under section 131(b)(1)) was $3,239,458.49. The petitioner claimed that Minera, during the period January 1, 1924 through 1947, had paid $3,496,615.43 to the Republic of Mexico under laws referred to herein as Mexican Income Tax Laws and Mexican Mining Tax Laws which the petitioner should be deemed to have paid.

The Commissioner, in determining the deficiency, allowed $1,103,292.06 of the credit claimed representing taxes under the Mexican Income Tax Laws converted from pesos to American dollars at the rates of exchange applicable at the time the payments were made. He disallowed the remainder of $2,136,166.43 which was based upon $2,393,323.37 of taxes paid under the Mexican Mining Tax Laws. The disallowance was made on the ground that the taxes paid under the latter law were not income taxes or taxes in lieu of income taxes within the meaning of section 131 of the Internal Revenue Code.

The taxes imposed by the Mexican Mining Tax Laws, credit for which has been disallowed, were imposed on the production of metals and metal compounds by the Mexican Mining Tax Laws of June 27, 1919, March 4, 1924, July 28,

1926, April 29, 1927, December 19, 1929, April 27, 1932, and August 31, 1934. They are referred to herein as production taxes. Minera properly deducted those production taxes but was not allowed to deduct for depletion, in computing its taxable net income for the various taxable years from 1924 through 1947 under the Mexican Income Tax Laws.

The Republic of Mexico owns all mineral in place within the Republic, and all mining of those minerals is through concessions from the Government. The concessions are granted without consideration but the Government has attempted to require the concessions to be worked or forfeited.

The Mexican Mining Tax Laws imposed production taxes upon the extraction of ore by the miner from the mineral deposit in Mexico. The products generally had to be delivered by their holders for payment of the production tax within 30 days following their production unless they were to be subjected to further treatment in Mexican plants, in which case the production tax was payable when the further processing in Mexico was completed. Payment of the production tax was due at the time of export if the product was exported prior to final treatment. The production tax was less if the treatment of the mineral was carried to completion in Mexico than it was if the material was exported before final treatment. Discounts on production taxes were allowed on the lower grade ores and on all ores mined during the first few years from a new mine or during the first few years from a reopened mine which had not been operated during the 10 previous years. The rate of tax on copper and silver and, after March 20, 1937, on lead and zinc, increased as the price of the metal increased above a fixed amount on the New York market as determined monthly by the taxing authorities of the Republic of Mexico.

The Mexican Mining Tax and Mining Fee Law of August 30, 1934 in Article 8 imposed a tax on the produc-

tion in Mexico of metals, metallic compounds for industrial uses and of non-metallic ores. The tax was on the value of the metal at rates which were highest on virgin ores and which declined through the various steps to produce the refined metal on which the rate was lowest. The rates on silver, for example, declined in 1 per cent stages from 6 per cent on virgin ores to 3 per cent on refined silver, but increased 1 per cent for each increase of 5 cents in the value of silver over 40 cents per troy ounce on the New York market. Article 13 provided as follows:

> The Treasury Department shall fix monthly the values for the metals and metallic compounds assessed under Article 8, taking the averages of the market prices in New York and the sight exchange between the dollar and our domestic currency during the next previous month, according to the sales rate of Banco de Mexico.
>
> When the metal or the product does not have regular quotation in New York, the Treasury Department shall determine the commercial or market value.

The states and territories from which the ores were mined received a small percentage of the production tax except in the case of low grade ores. The Federal Government alone could impose taxes on mining or production of ores or metal. Failure to pay the production tax did not lead to forfeiture of the mining concession.

Other Mexican Mining Tax Laws in effect from 1924 through 1947, while not identical with that of August 30, 1934, contained more or less similar provisions.

The Mexican Mining Tax and Mining Fee Law of August 30, 1934, also imposed taxes on mining concessions for the exploitation of metallic ores in proportion to the surface area overlying the mineral deposit.

The Mexican Income Tax Laws, which first went into effect on January 1, 1924 and continued through 1947 im-

posed annual income taxes under various schedules and required a separate return and computation of tax under each schedule. Schedule I imposed a tax on the net income of parties, *inter alia,* who operated an industrial business. Minera paid at least pesos 4,046,768.83 under that schedule during the 24-year period, but it paid no taxes under that schedule for the years 1930 through 1933, 1935, 1936, and 1938 through 1940. Schedule II imposed a tax on various kinds of interest, rents, royalties and premiums, and the total taxes paid by Minera for the 24-year period under those provisions amounted to at least pesos 1,578,319.26. Schedule II also imposed a tax on "profits distributed or which should be distributed by Mexican companies of all kinds" and Minera paid taxes for the years 1942 through 1947 under those provisions amounting to at least pesos 1,018,720.93. Schedule III imposed a tax on "taxpayers who, normally or occasionally, received participations, either in the form of rentals or otherwise, from the exploitation of the subsoil or concessions granted by the Federal or State Governments or Municipalities" and Minera paid taxes for the years 1925 through 1947 under those provisions amounting to at least pesos 348,013.57. Minera paid an "Extraordinary Tax" of pesos 185,443.21 in 1931. The above are the only provisions of the Mexican Income Tax Law under which Minera paid taxes during the 24-year period. The total paid was pesos 7,395,162.58. Income derived from the investment of capital in the exploitation of concessions granted by the Government was taxed at a substantially higher rate than income derived from capital invested in activities which required no concession from the Government. There was an additional rate under Schedule I for income from businesses operated under a concession from the Government, "except banks operating under Federal concessions and mining and petroleum concessions."

The department of the Ministry of Finance which administered the Mexican Income Tax Laws was entirely

separate from the department of the Ministry of Finance which administered the Mexican Production Taxes.

The Mexican Production Taxes paid by Minera from 1924 through 1947 were not income taxes or taxes in lieu of income taxes within the meaning of section 131(a)(1) or (h).

Minera, during the years 1924 through 1947, received payment for its products and discharged its obligations mostly in American dollars. It carried on its banking mostly in American dollars. The total amounts which it received in Mexican pesos were insufficient to pay its expenses which it incurred in Mexican pesos and it had to convert American dollars into pesos in order to meet those expenses.

The only figures which Minera used in keeping its books during the years 1924 through 1947 represented "pesos 2 for 1", an artificial unit of currency based upon and related only to the United States dollar which never changed in its relative value to the United States dollar. Entries under that system representing payments or receipts in American dollars were made by multiplying the number of dollars by 2 and entering that amount. Entries under that system representing payments or receipts in pesos were arrived at by reducing the pesos to American dollars at the rate of exchange in effect at the time of the payment or receipt and multiplying the amount in American dollars by 2.

Its tax returns filed in Mexico were on the basis of "pesos 2 for 1" except that the amounts were converted to pesos, at the then rate of exchange, in the final computation of the tax.

The dividend here in question was declared on August 4, 1947 by the Board of Directors of Minera who authorized distribution of 55 pesos 2 for 1 or $27.50 in United States currency per share.

All facts stipulated are incorporated herein by this reference.

Opinion

MURDOCK, *Judge:* The petitioner argues that the proceeds of mining have been regarded traditionally as being characteristically income and not mere conversions of capital or returns of cost, and the Mexican "Production Taxes have the characteristics of income or profits taxation by reason of their history, their purpose, their effects and their technical characteristics, that is to say, the presence in them of progressive rates of tax, of historical correlation with price and presumed profit, of adjustment of rate and incidence to costs and profits as manifested in their scheme of reductions and exemptions, and of directness of burden on the taxpayer as distinguished from susceptibility to shifting of the burden to others." This foreign tax, it says, must be tested by its functional characteristics, its purpose, operation, and effect and not by the extent to which it mirrors our own scheme of income taxation, if the credit in question is to carry out the policy of avoiding double taxation for which it was intended. It deems the credit proper where the foreign tax has an income base, even though the base is gross income. It cites a number of decisions to show that the proceeds of ores mined are gross income. It concludes that the proceeds of mining are like interest, dividends, and royalties which have always been viewed under our income tax thinking as having no capital content but as being in the nature of the rent, the usufruct, or the issue of the mining interest so that the tax falling upon mining proceeds would be the same as the tax falling on interest, dividends, royalties, or rentals, and would be a tax on income notwithstanding the absence of provisions for deductions. It reasons that the production taxes are not, as stated in I.T. 3945, C.B. 1949-1, 88, merely upon the value of ore produced, and therefore analogous to gross receipts or sales taxes. The production taxes, it claims, are not characterized by the fact that they apply percentages to values but are characterized rather by their profits

objective as shown by the expert testimony, the preambles of certain of the decrees, and the articulation of the whole tax scheme with mining profits.

The above, as well as all of the other arguments of the petitioner and of the respondent contained in their briefs, have been carefully considered in the light of the stipulated facts, the testimony of the witnesses, the decisions cited, and the provisions of section 131 in reaching the conclusion that the production taxes may not be regarded as income taxes or taxes in lieu of income taxes within the meaning of section 131(a)(1) or (h) so as to entitle the petitioner to the credit provided in section 131(f)(1). The evidence does not all point one way by any means and the difficulties of fully understanding the characteristics and purpose of this foreign tax are obvious. It is not practical to discuss every argument that has been made and the facts marshaled to support it. Nevertheless, some discussion of the petitioner's argument seems appropriate.

The petitioner cites Court decisions to show that mining proceeds have always been regarded as gross profits rather than gross receipts and argues that income taxes may be imposed upon gross profits. It may be conceded, at least for the purpose of discussion, that income taxes may be imposed upon gross profits, but the question here is whether, under all of the evidence in this case, the Mexican Production Taxes are to be regarded as income taxes or taxes in lieu of income taxes within the meaning of section 131(a)(1) or (h).

The petitioner relies upon the preambles to several decrees relating to the production taxes to show that the Mexican Government intended to impose a tax on income through the production taxes. The evidentiary value of the decrees to the petitioner is not undiluted. One of November 25, 1919 changed the production tax rate on silver ostensibly because an increase in world prices of the metal constituted a source of great unearned profit to producers

which the nation could share without burdening the mining industry. Another of December 24, 1920 changed the production tax rate on silver because of a fall in the value of silver forcing some mines out of business and the Government felt it should permit them to obtain some profits. The third, dated April 11, 1935, again changed the rate on silver and recited:

> WHEREAS, in the measure that silver reaches a higher price in the world market, the profits of the mining companies become larger and larger, without this additional increase of wealth entailing greater efforts on the part of the operators or an additional investment of capital, since when the silver reaches a price which guarantees productivity of operations and a reasonable margin of sure profits, subsequent increases in the sales price constitute super earnings not in relation to the effort and the capital of the producer;
>
> WHEREAS, the direct ownership of the mineral deposits, established without discussion from Colonial times in favor of the Crown of Castile and subsequently transferred to the Nation in the form at present expressly consecrated in Article 27 of the Federal Constitution, would not really be such direct ownership, if during the boom times the Nation did not obtain from the mining proceeds its proper share, both through its right of ownership and the authority which said Article 27 confers for "regulating the advantage and use of the natural elements susceptible to appropriation, to permit a fair distribution of the public wealth and to care for its preservation"; and
>
> WHEREAS, the taxes on the production of silver should not be raised any further, while the price of this product does not rise above 77 pesos per kilogram, but, on the other hand, if the prices rise

higher, it shall be fully justified to collect a part of the excess by way of taxes, applying them to purposes which might redound to the immediate benefit of the Nation; I considered it advisable to issue the following Decree:

* * * * *

A decree of February 11, 1931 granted some exemptions after reciting that the mining industry represented the main support of the national economy and a decline in that industry would aggravate the depressing exchange situation. Another dated January 1, 1935 provided that the rate of production tax on silver and copper would depend upon the New York prices converted into pesos at current exchange rates. That was done so that the Mexican Government would not suffer loss of taxes due to the decline of the exchange value of the pesos. The fact that the rates of production taxes were lower on refined metals than on virgin ores was to encourage complete processing in Mexico and sheds no particular light on the present question. It is obvious from the decrees, the "progressive rates" and the testimony, that the Mexican Government, in imposing the production taxes, gave some consideration to the profit problems of the miners and the industry, as well as to the share of the value of the metals which the state should have as a result of its ownership of the ores in place, nevertheless, it did not base the production taxes on profits so as to make those taxes income taxes. Real estate taxes might conceivably be reduced during a depression for somewhat similar reasons without thereby indicating that profits were the basis of the tax.

The principal argument of the petitioner is that the production taxes were income taxes and it does not make an extensive separate argument that they were taxes in lieu of income taxes. They were in effect before Mexico imposed any income taxes and they continued to be in effect thereafter without substantial change. It is not apparent

that any change was made in the production taxes as a result of the later enactment of the Mexican Income Tax Laws. There is evidence that under one or more of the schedules the income taxes on miners were somewhat less than on other concessionaires of the Government, but that circumstance is not relied upon and is insufficient to show that the production taxes were "taxes in lieu of income taxes" within the meaning of section 131(h). The record does not justify a finding that the production taxes were ever intended to be or were taxes in lieu of income taxes.

The production taxes for which credit is claimed were imposed and paid during the 24 years from 1924 through 1947. Mexican Income Tax Laws were also in effect during all of those years. The production taxes were in effect prior to that period but the income taxes were not. The production taxes paid by Minera during the 24 years amounted to more than three times the income taxes paid during that same period. Annual deductions, including one for the production taxes but none for depletion, were allowed in computing the net income of Minera for Mexican income tax purposes, but deductions were not granted under the Mexican Production Tax Laws. The Republic of Mexico owned the ore in place, the mining of which gave rise to the production taxes. The miner paid the Government nothing for the minerals mined except as the taxes, particularly the production taxes, might represent such payment. The production taxes were payable when the metals were mined regardless of whether or not they were subsequently sold and regardless of whether or not any profit resulted. Minera did not pay income taxes during at least 9 of the 24 years, due to losses or insufficient income, but it was required to pay production taxes in each of the 24 years. These are some of the circumstances which have led to the conclusion that the production taxes were not income taxes.

The only other question requiring decision is the issue raised by the respondent. He claims that he erred in allowing a credit based upon payments converted into dollars at the rate of exchange prevailing at the times when the taxes were paid. He relies heavily upon the case of *Bon Ami Co.*, 39 B. T. A. 825, but that case is not in point. There, the foreign taxpayer kept its books on the basis of the foreign currency so that the foreign tax paid, the accumulated earnings, and the ultimate dividend were all in terms of foreign currency and there was no occasion to reduce any of them to United States currency until the dividend was paid and the credit computed. Here the foreign subsidiary kept its books so that tax payments, earnings, and dividends were currently and exclusively reflected in the equivalent of United States currency as opposed to foreign currency, and the "proportionate part" of the foreign tax represented in the dividend can only be determined by reference to the subsidiary's books. The exchange rate at the time the foreign taxes were paid and accounted for was used to translate those payments into United States currency for entry in the books at that time. Thus, the exchange rate at the date of the dividend had no relation to the amount of the foreign tax paid, to the accumulated earnings, or to the dividend paid. The whole account of Minera had been stated from start to finish in the equivalent of dollars rather than in the equivalent of Mexican pesos, and no foreign exchange problem arises.

The result of this decision is to leave the parties where we found them on both issues.

Reviewed by the Court.

Decision will be entered in accordance with the notice of deficiency.

Decision

THE TAX COURT OF THE UNITED STATES

WASHINGTON

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated February 20, 1953, it is

ORDERED AND DECIDED: That there is a deficiency in income tax of $2,180,517.99 for the year 1947.

Enter:

(Signed) J. E. MURDOCK
Judge.

Entered FEB 26 1953

APPENDIX B

Statutes and Regulations Involved

The pertinent provisions of Section 131 of the Internal Revenue Code are the following:

"Sec. 131. Taxes of Foreign Countries and Possessions of United States

"(a) ALLOWANCE OF CREDIT. If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except the tax imposed under section 102, shall be credited with:

> "(1) *Citizens and Domestic Corporations.* In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and
>
> * * *

"(b) LIMIT ON CREDIT. The amount of the credit taken under this section shall be subject to each of the following limitations:

> "(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed, * * * in the case of a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's normal-tax net income from sources within such country bears to its entire normal-tax net income for the same taxable year; and
>
> "(2) The total amount of the credit shall not exceed, * * * in the case of a corporation, the same proportion of the tax against which such credit is taken, which the taxpayer's normal-tax net income from

sources without the United States bears to its entire normal-tax net income for the same taxable year; and*

"(f) TAXES OF FOREIGN SUBSIDIARY.

"(1) *Foreign Subsidiary of Domestic Corporation.* For the purposes of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; and the Commissioner with the approval of the Secretary shall have full power to determine from the accumulated profits of what year or years such dividends were paid; treating dividends paid in the first sixty days of any year as having been paid from the accumulated profits of the preceding year or years (unless to his satisfaction shown otherwise), and in other respects treating dividends as having been paid from the most recently accumulated gains, profits, or earnings. In the case of

* Section 122(g)(6) of the Revenue Act of 1945 (59 STAT. 570) repealed former subdivision (3) of Section 131(b) but failed to change the punctuation and direct deletion of the word "and".

a foreign corporation, the income, war-profits, and excess-profits taxes of which are determined on the basis of an accounting period of less than one year, the word "year" as used in this subsection shall be construed to mean such accounting period.

• • •

"(h) CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES. For the purposes of this section and section 23 (c) (1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-profits otherwise generally imposed by any foreign country or by any possession of the United States."

The pertinent provisions of Title 26 of the Code of Federal Regulations are as follows:

"Sec. 29.131-1. Analysis of credit for taxes.

"If the taxpayer chooses to claim a credit for taxes, the basis of such credit, in the case of a citizen of the United States, whether resident or nonresident, and in the case of a domestic corporation, is as follows: (a) The amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; • • •

• • •

"If a taxpayer chooses to claim a credit for taxes, such action will be considered to apply to income, war-profits, and excess-profits taxes paid to all foreign countries and possessions of the United States, and no portion of any such taxes shall be allowed as a deduction from gross income."

• • •

"Sec. 29.131-2. Meaning of terms.

"The term "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable

year'' means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. For the purposes of section 131 and section 23(c)(1) the term ''income, war-profits, and excess-profits taxes'' includes a tax imposed by statute or decree by a foreign country or by a possession of the United States if (a) such country or possession has in force a general income tax law, (b) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and (c) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X country, which imposes an income tax upon substantially a net income base. The ascertainment of net income, though not the determination of gross income, from sources in X country is found administratively difficult. The X country, by decree, provides that corporations circumstanced as was the A Corporation would, in lieu of the income tax at the rate of 20 percent otherwise payable, be subject to tax at the rate of 10 percent upon the amount of gross income from X country. In accordance with such decree, the A Corporation paid X country the sum of $25,000 in 1943 with respect to its tax liability to the X country for the year 1942. Such amount, subject to the applicable limitations, is available as a credit to the A Corporation as foreign income, war-profits, or excess-profits taxes against the United States tax liability for the year 1942.''

* * *

''Sec. 29.131-7. Taxes of subsidiary corporations.

''(a) *Domestic corporation owning a majority of the stock of a foreign corporation.* In the case of a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends

in any taxable year, the credit for foreign taxes includes not only the income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States by such domestic corporation, but also income, war-profits, and excess-profits taxes deemed to have been paid determined by taking the same proportion of any income, war-profits, and excess-profits taxes paid or accrued by such controlled foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of any such dividends received bears to the amount of such accumulated profits. See, however, the limitations provided in section 131 (b) and section 29.131-8. If dividends are received from more than one controlled foreign corporation, the limitation is to be computed separately for the dividends received from each controlled foreign corporation. If the credit for foreign taxes includes taxes deemed to have been paid, the taxpayer must furnish the same information with respect to the taxes deemed to have been paid as it is required to furnish with respect to the taxes actually paid or accrued by it. Taxes paid or accrued by a controlled foreign corporation are deemed to have been paid by the domestic corporation for purposes of credit only."

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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 146

THE AMERICAN METAL COMPANY, LIMITED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 272a-286a; Pet. A-18-A-30) are reported at 19 T.C. 879. The opinion of the Court of Appeals (Pet. A-3-A-17) is reported at 221 F.2d 134.

JURISDICTION

The judgment of the Court of Appeals was entered on March 15, 1955. (Pet. A-1-A-2.) The petition for a writ of certiorari was filed June 13, 1955.

The jurisdiction of this Court rests upon 28 U.S.C., Sec. 1254.

QUESTION PRESENTED

Whether the production taxes imposed under the Mexican Mining Tax Laws and paid by Minera, taxpayer's Mexican subsidiary, in the years 1924 through 1947, were income taxes or taxes paid by Minera in lieu of income taxes within the meaning of Section 131 of the Internal Revenue Code of 1939, so as to entitle taxpayer to a foreign tax credit for the payment of such taxes by Minera.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.
>
> (a) [as amended by Sec. 158(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter, except * * *, shall be credited with:
>
> (1) *Citizens and domestic corporations.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and
>
> * * * * *
>
> (f) [as amended by Sec. 158(e) of the Revenue Act of 1942, *supra*, and Sec. 130(b) of the Revenue

Act of 1943, c. 63, 58 Stat. 21] *Taxes of Foreign Subsidiary.*—

(1) *Foreign subsidiary of domestic corporation.*—For the purposes of this section, a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. The term "accumulated profits" when used in this subsection in reference to a foreign corporation, means the amount of its gains, profits, or income in excess of the income, war-profits, and excess-profits taxes imposed upon or with respect to such profits or income; * * *.

* * * * *

(h) [as added by Sec. 158(f) of the Revenue Act of 1942, *supra*] *Credit for Taxes in Lieu of Income, Etc., Taxes.*—For the purposes of this section and section 23(c)(1), the term "income, war-profits, and excess-profits taxes" shall include a tax paid in lieu of a tax upon income, war-profits, or excess-

profits otherwise generally imposed by any foreign country or by any possession of the United States.

* * * * *

(26 U.S.C. 1952 ed., Sec. 131.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.131-2. *Meaning of Terms.*—The term "amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year" means taxes proper (no credit being given for amounts representing interest or penalties) paid or accrued during the taxable year on behalf of the taxpayer claiming credit. For the purposes of section 131 and section 23(c)(1) the term "income, war-profits, and excess-profits taxes" includes a tax imposed by statute or decree by a foreign country or by a possession of the United States if (a) such country or possession has in force a general income tax law, (b) the taxpayer claiming the credit would, in the absence of a specific provision applicable to such taxpayer, be subject to such general income tax, and (c) such general income tax is not imposed upon the taxpayer thus subject to such substituted tax. For example, the A Corporation does business in the X country, which imposes an income tax upon substantially a net income base. The ascertainment of net income, though not the determination of gross income, from

sources in X country is found administratively difficult. The X country, by decree, provides that corporations circumstanced as was the A Corporation would, in lieu of the income tax at the rate of 20 percent otherwise payable, be subject to tax at the rate of 10 percent upon the amount of gross income from X country. In accordance with such decree, the A Corporation paid X country the sum of $25,000 in 1943 with respect to its tax liability to the X country for the year 1942. Such amount, subject to the applicable limitations, is available as a credit to the A Corporation as foreign income, war-profits, or excess-profits taxes against the United States tax liability for the year 1942.

* * *

STATEMENT

The Tax Court made detailed findings of fact (R. 274a-280a; Pet. A-19-A-24) based largely on a detailed stipulation of facts (R. 13a-92a). For present purposes the facts may be summarized as follows:

Taxpayer is a New York corporation which owns a majority of the stock of Compania Minera de Penoles, S. A. (hereinafter called Minera), a Mexican corporation engaged, in Mexico, in the business of mining, milling, smelting and refining non-ferrous metals directly and through subsidiaries. In August 1947 Minera paid a taxable dividend to its shareholders, in the amount of $8,250,000, out of its earnings and profits accumulated since 1924. Tax-

payer received $8,110,932.50 of the dividend distribution. In its consolidated income tax return for the calendar year 1947, taxpayer chose to take the foreign tax credit authorized by Section 131 of the Internal Revenue Code of 1939 for foreign income taxes paid by a subsidiary on the earnings and profits distributed to the parent. The credit was claimed by taxpayer in an amount which covered taxes paid by Minera during the years 1924 through 1947 under the Mexican *Income* Tax Laws and also production taxes paid under the Mexican *Mining* Tax Laws. The Commissioner disallowed the portion of the claimed credit attributable to the production taxes paid by Minera under the Mexican *Mining* Tax Laws, on the ground that such taxes were not income taxes or taxes paid in lieu of income taxes within the meaning of Section 131 of the Code. (R. 13a-17a, 29a-31a, 33a, 274a-275a.)

The nature of the Mexican *Income* Tax Laws, as well as the amounts paid by Minera thereunder for each of the years 1924 through 1947, is reflected in the Tax Court's findings of fact (R. 277a-278a; Pet. A-22-A-23; see, also, R. 33a, 92a) and will not be restated here.[1] The production taxes paid by Minera under the Mexican *Mining* Tax Laws, for which credit has been disallowed, were deductible and were deducted by Minera in computing its taxable income under the Mexican *Income* Tax Laws for each of the years 1924 through 1947. (R. 25a-26a, 275a; Pet. A-21.)

---

[1] The provisions of the Mexican Income Tax Laws are reflected in Exhibit 7-G (see R. 27a-28a), which is not contained in the printed record.

The Republic of Mexico owns all mineral in place within the Republic and all mining of those minerals is through concessions from the Government. The concessions are granted without consideration but the Government has attempted to require the concessions to be worked or forfeited. (R. 275a-276a; Pet. A-21.)

The Mexican *Mining* Tax Laws in effect from 1924 to 1947 (R. 26a, 27a) contained provisions similar to the Mining Tax Law of August 30, 1934 (R. 277a; Pet. A-22), which is contained in the record at pages 35a-57a.[2] Chapter III of that law (R. 37a-42a), relating to the production taxes for which credit has been disallowed, imposed tax on the production in Mexico of metals, metallic compounds for industrial uses and non-metallic ores. The tax was imposed at fixed rates on the value of the metals and metallic compounds as determined monthly on the basis of the averages of the New York market prices and the sight exchange between the dollar and the Mexican currency. The rates at which the tax was imposed were highest on virgin ores and declined through the various steps involved in producing the refined metal, on which the rate was lowest. The rates on silver, for example, declined in one per cent stages from six per cent on virgin ores to three per cent on refined silver, but increased one percent for each increase of five cents in the value of silver, over

[2] The other Mexican Mining Tax Laws are not contained in the printed record, although English translations thereof were exhibits to the stipulation of facts.

forty cents per troy ounce, on the New York market. (R. 276a-277a; Pet. A-21-A-22.)

The production taxes were imposed upon the extraction of ore by the miner from the mineral deposit in Mexico. The products generally had to be delivered by their holders for payment of the production tax within 30 days following their production unless they were to be subjected to further treatment in Mexican plants, in which case the production tax was payable when the further processing in Mexico was completed. Payment of the production tax was due at the time of export if the product was exported prior to final treatment. The production tax was less if the treatment of the material was carried to completion in Mexico than it was if the material was exported before final treatment. Discounts on production taxes were allowed on the lower grade ores and on all ores mined during the first few years from a new mine or during the first few years from a reopened mine which had not been operated during the ten previous years. (R. 276a; Pet. A-21.)

The department of the Ministry of Finance which administered the production taxes was entirely separate from the department of the Ministry of Finance which administered the Mexican Income Tax Laws. (R. 279a.)

The Tax Court held that the Mexican production taxes were not income taxes or taxes paid in lieu of income taxes within the meaning of Section 131 of the Code. (R. 280a-285a; Pet. A-25-A-29.) The Court of Appeals affirmed. (Pet. A-4-A-15.)

ARGUMENT

As reasons for granting the writ, taxpayer asserts that the decision below presents an important question which should be settled by this Court and that the court below has misinterpreted and misapplied decisions of the Court. (Pet. 11-21.) Both assertions are incorrect.

1. Contrary to taxpayer's argument (Pet. 11-15), there is no unsettled question as to the standard to be applied in determining the types of foreign taxes entitled to credit under Section 131 of the Internal Revenue Code of 1939, *supra*, pp. 2-4. The statute itself fixes the types of taxes entitled to credit by authorizing the credit for the payment of "income * * * taxes" (Section 131 (a)(1) and (f)(1)). This includes, as declared in subsection (h), "a tax paid in lieu of a tax upon income * * * otherwise generally imposed by any foreign country * * * " (Section 131(h)). The standard for determining what constitutes "income * * * taxes" for the purpose of Section 131 is set forth in this Court's decision in *Biddle* v. *Commissioner*, 302 U.S. 573, where it was stated (p. 579) that the phrase "income taxes paid" in Section 131 must be interpreted according to its meaning as used in our own revenue laws. Thus, whether the taxpayer there had paid the tax was held to depend upon whether his actions in conformity with foreign law were "the substantial equivalent of payment of the tax as those terms are used in our own statute." (*ibid.*) Following that decision, the lower courts, as in the present

case (see Pet. A-8), have properly and consistently held that, in determining whether a foreign tax is an income tax for the purposes of Section 131, the controlling criterion is whether the foreign tax is the substantial equivalent of an income tax as that term is understood in the United States. See *Keasbey & Mattison Co.* v. *Rothensies,* 133 F. 2d 894, 897 (C.A. 3d), certiorari denied, 320 U.S. 739; *New York & H. Rosario Min. Co.* v. *Commissioner,* 168 F. 2d 745, 747 (C.A. 2d); *Northwestern Mut. F. Ass'n* v. *Commissioner,* 181 F. 2d 133 (C.A. 9th); *St. Paul Fire & Marine Ins. Co.* v. *Reynolds,* 44 F. Supp. 863 (D. Minn.). The standard for determining what constitutes "a tax paid in lieu of a tax upon income" is stated in Section 29.131-2 of Treasury Regulations 111, *supra,* pp. 4-5, which is expressive of the Congressional purpose in enacting subsection (h). See S. Rep. No. 1631, 77th Cong., 2d Sess., p. 131 (1942-2 Cum. Bull. 504, 602).

More precise standards, even if feasible, are not required as a guide to decision in the present case, for the Mexican production tax clearly does not meet the United States concept of an income tax. Under our revenue laws a tax on income is a tax on gains and profits, as the courts have held in applying Section 131. *Keasbey & Mattison Co.* v. *Rothensies,* 133 F. 2d 894, 897 (C.A. 3d), certiorari denied, 320 U.S. 739; *Northwestern Mut. F. Ass'n* v. *Commissioner,* 181 F. 2d 133, 135 (C.A. 9th); *St. Paul Fire & Marine Ins. Co.* v. *Reynolds,* 44 F. Supp. 863, 865 (Minn.). As applied to mining operations, which resemble a manufacturing busi-

ness carried on by the use of the soil and are treated as income-producing operations, our income tax is imposed on the miner's net profits, consisting of gross proceeds less allowable deductions. See *Anderson* v. *Helvering*, 310 U.S. 404; *Burnet* v. *Harmel*, 287 U.S. 103. Contrariwise, the Mexican production tax is imposed on the production of metals; it is measured by the value of the metals produced; and it attaches when the ore is extracted from the subsoil irrespective of whether any profit results and even irrespective of whether the metal is subsequently sold. Thus, the Mexican production tax, instead of being a tax on income within the United States concept, falls into the classification of a privilege tax (see *Oliver Iron Co.* v. *Lord*, 262 U.S. 172; *Hope Gas Co.* v. *Hall*, 274 U.S. 284). It is measured by the value of the metal mined and, as the court below held (Pet. A-9-A-11), is a condition of extracting ore which belongs to the Republic of Mexico.

2. Taxpayer argues (Pet. 16-21) that the court below erred in giving weight to decisions of this Court holding that a privilege tax measured by income is not an income tax. See, *e.g.*, *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 162, 163-164; *McCoach* v. *Minehill Railway Co.*, 228 U.S. 295, 306-308; *Stratton's Independence* v. *Howbert*, 231 U.S. 399, 414; *Anderson* v. *Forty-Two Broadway Co.*, 239 U.S. 69, 72.[3] The suggestion is that these cases

[3] The court below did not cite those cases but apparently included them in the reference (Pet. A-10) to *Keasbey &*

are inapposite for purposes of determining availability of foreign tax credit because they are based on a "subject" and "measure" analysis "founded in constitutional necessities" (Pet. 17). But certainly a decision as to the nature of a tax is not lacking in persuasiveness because the question arose in the context of a constitutional challenge to the taxing power.[4] As pointed out above, it is the United States concept of the nature of the tax which is controlling under Section 131.

In any event, so far as the Mexican production tax is concerned, there is no occasion for debate as to the soundness of the "subject" and "measure" distinction. There is no conceptual problem here, for income is neither the subject nor the measure of the tax. The tax has relation to income only in the vague sense that, as the court below stated (Pet. A-12), the rate of the tax varies with a factor which affects the prosperity of the mining industry generally. As the court below also stated, the Mexican production tax is more clearly and certainly a privilege tax than the Quebec tax held to be a privilege tax in *Keasbey & Mattison Co.* v.

Mattison Co. v. *Rothensies*, 133 F. 2d 894 (C. A. 3d), certiorari denied, 320 U. S. 739, as a case which "cites numerous cases which lend still further support to our conclusion."

[4] *Interstate Pipe Line Co.* v. *Stone*, 337 U. S. 662, *Spector Motor Service* v. *O'Connor*, 340 U. S. 602, and *Railway Express Agency* v. *Virginia*, 347 U. S. 359, cited by petitioner (Pet. 17-18), involved the impact of state privilege taxes on interstate commerce and in nowise detracted from the Court's prior holdings that a privilege tax is not an income tax.

Rothensies, 133 F. 2d 894 (C.A. 3d), certiorari denied, 320 U.S. 739.

CONCLUSION

The decision below is clearly correct and in full accord with the decisions of this Court. There is no conflict among the circuits. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY 1955.

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